Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

February 2012

Europe

Bulgaria

On January 1, a new law took effect that accelerates a previously legislated increase in the retirement age for men and women and introduces a bonus for workers who delay retirement. The law, which was passed by parliament in December after overcoming a presidential veto, is intended to ensure the long-term financial stability of Bulgaria's pension system. According to recent estimates, the National Social Security Institute currently has a budget deficit of around 1 billion euros (US$1.3 billion).

Under the new law, the retirement age for men and women increased by 4 months—to age 63 and 4 months for men and to age 60 and 4 months for women. From 2013 to 2017, retirement ages will continue to increase by 4 months each year, until reaching age 65 for men and age 63 for women. (A law passed in December 2010 would have increased the retirement ages to 65 (men) and 63 (women) by 6 months a year starting in 2021.) The number of contribution years required to receive a pension also increased by 4 months (as part of the 2010 law)—to 37 years and 4 months for men and to 34 years and 4 months for women. That will continue to increase by 4 months each year until reaching 40 years for men and 37 years for women. Finally, as an incentive to work longer, people who continue to work after reaching the retirement age will receive a 4 percent bonus for each year that they delay claiming benefits.

Bulgaria's pension system consists of a first-pillar earnings-related pay-as-you-go program, second-pillar individual accounts that are mandatory for all workers born after 1960, and third-pillar voluntary individual accounts. Since January 2011, employers contribute 10 percent of covered payroll and employees contribute 7.8 percent of covered earnings. For workers born before 1960, all employer and employee contributions are directed to the first-pillar program; for workers born in or after 1960, contributions are divided between the first-pillar and second-pillar programs.

Sources: *Social Security Programs Throughout the World: Europe, 2010*, US Social Security Administration; "Bulgaria," *International Update*, January 2011, US Social Security Administration; "Pension Reform Sparks Mixed Reactions in Bulgaria," *Southeast European Times*, December 8, 2011; "Bulgaria's Controversial 'Pension Reform' Kicks In," *Sofia News Agency*, January 1, 2012; "2012 Changes in System of Retirement," *Radio Bulgaria*, January 4, 2012.

Denmark

On January 1, a new law entered into force that scales down the government-subsidized voluntary early retirement program (VERP or efterlon) to encourage older workers to remain in the labor force and to reduce government costs. The law allows current account holders to opt out of the program (and receive a lump-sum payment), gradually increases the VERP eligibility age, and gradually decreases the number of years the benefit is paid. Those measures, expected to lower government expenditures by some 16 billion kroner (US$2.8 billion) per year, will be phased in according to the following schedule:

- Between April 2 and October 1, 2012, workers who contributed to VERP will be permitted to opt out of the program and withdraw their contributions as a tax-free lump sum; those who continue to participate until the age of eligibility (currently age 60) will be able to choose between a tax-free lump sum of 143,300 kroner (US$25,339) and a reduced VERP benefit.
- From 2014 through 2023, the VERP eligibility age will gradually increase from age 60 to 64. (A 2006 law had scheduled an increase in the age to 62 from 2019 through 2028.)
- From 2018 through 2023, the number of years the VERP benefit is paid will gradually decrease from the current 5 years to 3 years.

No changes were made to the scheduled gradual increase in the full retirement age by 2 years to age 67, from 2024 to 2027. Subsequently, both the early and full retirement ages will be adjusted every 5 years according to the mean life expectancy of 60-year-olds.

VERP was introduced in 1979 to encourage older workers to leave the labor force in order to open up jobs for younger workers. (After the VERP benefits have been exhausted, a worker may receive a full retirement benefit.) The program was intended for workers in physically or mentally demanding jobs who were not eligible for a disability benefit. At the time, the government expected some 17,000 workers to take early retirement. By 2009, the program had some 135,000 beneficiaries.

Under the new law, the government will also introduce a new "senior" disability benefit program (Seniorfortidspension) for those workers over age 62 in physically demanding jobs who have work-related health problems and cannot continue to work. Neither worker contributions nor membership in an unemployment insurance fund will be required. The evaluation process will have to be short because a decision must be made within 6 months after the application is filed.

VERP is part of the unemployment program and requires membership in an unemployment compensation fund. In addition to government subsidies, a portion of workers' membership contributions to an unemployment fund finances VERP. In some instances, employers also make contributions. The rest of Denmark's retirement income system consists of an earnings-tested universal pension based on residence; ATP, the labor-market supplementary pension that varies according to the worker's account balance; and occupational pensions.

Sources: *Social Security Programs Throughout the World: Europe, 2010*, US Social Security Administration; "Parliament Approves a Leaner, Meaner Early Retirement," *Copenhagen Post*, December 22, 2011; "OECD Economic Surveys: Denmark 2012," January 2012; "International Headlines," *Mercer*, January 5, 2012; "Retirement Reform Will Make 25,000 Unemployed," European Industrial Relations Observatory Online, January 20, 2012.

France

On December 21, 2011, parliament adopted new legislation that accelerates the increase in the retirement age specified in the 2010 pension reform. Along with a series of measures affecting other branches of social security, the increase in the retirement age formed part of the austerity measures passed by the French government in 2010 to respond to the decline in economic activity and the consequent decrease in revenues to the French social security system. By accelerating the increase, the French government hopes to ease the system's financial burden.

As a result of the new legislation, the retirement ages for both men and women will increase by 4 months a year, from age 60 to 62 (for a reduced early retirement benefit) and from age 65 to 67 (for retirement at the full benefit rate) beginning in 2017, a year earlier than what was scheduled in the 2010 law. That means workers born in 1956 will be the first cohort with retirement ages of 62 and 67, respectively. The 2010 law also introduced a series of other changes such as easing the transition to retirement for workers in arduous and dangerous occupations, improving the employment prospects of older workers, and reducing the retirement income differential between men and women.

France's retirement income system consists of an earnings-related public pension and mandatory occupational pensions administered jointly by employers and employees. Workers who have reached the qualifying conditions for a full pension and remain in the labor force will receive an additional 5 percent for each subsequent year of activity under the earnings-related public system.

Sources: *Social Security Programs Throughout the World: Europe, 2010*, US Social Security Administration; "Focus on France," *International Update*, December 2010, US Social Security Administration; *Pensions at a Glance 2011: Retirement-Income Systems in OECD and G20 Countries*, Organisation for Economic Co-operation and Development, 2011; Loi n°2011-1906 du 21 décembre 2011.

Asia and the Pacific

China

On January 20, the federal government announced a pilot program that will broaden pension fund investments for jurisdictions in the 13 provinces already managing individual retirement accounts. The council that manages the National Social Security Fund (NSSF), China's public pension reserve fund, will act as principal investor and trustee for each of those systems and will be permitted to invest a portion of their assets in domestic equities and other higher-yielding instruments. That could involve as much as 360 billion yuan (US$57 billion), roughly 20 percent of the funds' combined total assets under management. The government expects the new program to improve returns for retirement savings and to help develop China's capital markets.

Provincial pension funds and those of most urban areas are currently limited to investing in low-yielding bank deposits and government bonds that have averaged less than 2 percent over the past 10 years (a negative return on an inflation-adjusted basis). At the same time, however, NSSF has averaged an annual return of nearly 9.2 percent by investing up to 40 percent in securities. At the end of 2010, the assets of China's urban pension funds totaled roughly 1.5 trillion yuan (US$227 billion), while assets in the national rural insurance plan, implemented in 2009 for agricultural and other self-employed workers, amounted to 42.3 billion yuan (US$6.4 billion).

NSSF was established in 2000 to support future social security expenditures as China's population (currently 1.35 billion) ages. A recent report by the Chinese Academy of Social Sciences notes that China currently has three workers for every pensioner, but that ratio is projected to decline to one worker for every two pensioners in 30 years.

Sources: "China Pension Funds Wrestle with Large Deficits," Caixin Online, December 25, 2011; "China Pension Funds Closer to Stock Investing: Door to Stock Markets Appears to be Opening Despite Risk Concerns," MarketWatch, January 15, 2012; "China Eyes Pension Fund Boost for Stock Market," Reuters News, January 19, 2012; "China Opens New Investment Channels for Pension Funds," Xinhua's China Economic Information Service, January 20, 2012; "WSJ: China Set to Free Local Pensions to Flow into Stock Market," Dow Jones International News, January 20, 2012.

Reports and Studies

Organisation for Economic Co-operation and Development (OECD)

On January 25, OECD released *Pensions at a Glance: Asia/Pacific 2011,* which examines pension systems in the region and updates the 2008 volume. The report urges most of the countries in the region to quickly "modernize" their systems to ensure adequate and sustainable retirement incomes for the current labor force. According to the report, the region's population is rapidly aging; by 2050, the percent of the population over age 65 in the Asian and non-OECD Pacific countries surveyed is expected to almost triple and reach 17 percent.

The report also finds that the relatively high replacement rates and early retirement ages in some countries cannot be maintained as the population ages. In China, for example, the replacement rate (as a percentage of individual lifetime average earnings) for an average worker is 78 percent for men and 51 percent for women, and the retirement ages are 60 and 55, respectively. (In comparison, the average replacement rate for workers at average earnings across OECD countries is 57.3 percent for men and 55.7 percent for women, while the average retirement age is 65 for both.) On the other hand, retirement benefits in several other countries already provide low replacement rates: Singapore's rate is the lowest at 12.7 percent.

According to the report, the main reasons that countries in this region will not be able to provide adequate retirement income for most workers are as follows:

- Their formal pension systems have low rates of coverage. In South Asia, 10.5 percent of the working-age population is covered by a pension system, compared with 26 percent in East Asia. The average across all OECD countries is 70 percent.
- Workers often withdraw a portion of their savings before retirement, which results in lower retirement income.
- Because few countries provide pensions, most payouts at retirement are in the form of a lump sum. As a result, retirees run the risk of outliving their savings.
- Adjustments to pensions according to changes in the cost of living are often ad hoc. That means the value of the benefit erodes over time because it does not keep up with inflation.

In addition to the issue of benefit adequacy, the report promotes switching from a benefit formula based on final salary to one based on average lifetime earnings. Final salary formulas favor workers whose earnings increase as they age at the expense of lower-income workers with flat career earnings (such as manual workers). Final salary formulas also encourage underreporting of earnings, noncompliance in the early years of the work history, and artificial increases in final pay. In the Asia/Pacific region, countries such as India and Pakistan use final salaries, but only Vietnam plans to base pensions on average salary. Most OECD countries use lifetime average earnings.

Pensions at a Glance: Asia/Pacific 2011 also contains detailed country profiles on the public and private pension systems of 16 Asian countries.

Source: *Pensions at a Glance: Asia/Pacific 2011*, OECD, 2011.

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